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Introduction

In 1996, the Competition Tribunal ruled that the major financial institutions were abusing their dominant position with regards to Automated Teller Machines (ATMs).¹ As a result, it was determined that ATMs could be privately owned, leading to the creation of the white-label ATM industry. By 2001, of the more than 35,000 ATMs in Canada, over 18,000 were white-label ATMs.²

White-label ATMs allow cardholders to withdraw funds from an account held at any financial institution by dispensing cash to them upon request. They do not display a logo from any financial institution. White-label ATMs can be found at a variety of locations, including retail outlets, bars, and gas stations. They are to be distinguished from ATMs owned by financial institutions, that have a wider range of functions including bill payments, account deposits, and other miscellaneous transactions.

The objective of this paper is to describe how white-label ATMs may be vulnerable to money laundering. It is divided in two sections. The first section elaborates on the advantages of owning a white-label ATM, regulatory environment, ownership hierarchy, and settlement process of white-label ATMs. The second section details, through analysis of FINTRAC data, the two main vulnerabilities of white-label ATMs: operator anonymity and potential for placement activities.

I – Understanding how White-Label ATMs Operate

This section describes the operational aspect of white-label ATMs. It explains the advantages of owning or operating a white-label ATM, details the regulations currently in place concerning white-label ATMs, describes the complexity involved in determining exactly which individuals operate white-label ATMs, and outlines the settlement process of white-label ATMs.

Advantages of Owning / Operating a White-Label ATM

Business owners may install a white-label ATM in their business to provide them with any of the following advantages³:

- Decrease in the business's dependence on credit cards, reducing the transaction costs;
- Increase in the security of funds because cash is more secure than cheques (and certain other forms of payment);

¹ *Director of Investigation and Research v. Bank of Montreal et al. and in the matter of an abuse of dominant position in the supply of shared electronic network services for consumer-initiated shared electronic financial services*, Proceeding 1, CT – 95/2, Competition Tribunal (June 20 1996).

² “White-Label ATMs”, The Public Interest Advocacy Centre, [ONLINE], page consulted March 30th 2007, www.piac.ca/financial/_white_label_atms_â_taking_awayâ_consumersâ_cash_as

³ *ATM FAQs*, The ATM Business, [ONLINE], page consulted March 26th 2007, http://www.theatmcompany.com/traconev/business/section_05.html#benefit

- Increase in foot traffic and customer loyalty due to the convenience of the ATM; and
- Potential increase in total sales and the purchase of impulse products (because direct access to cash increases the amount of money spent).

A business owner may or may not operate the white-label ATM installed in their business. If the white-label ATM is loaded with cash from the business in which it is installed, cash transportation/insurance costs are eliminated, and bank transaction costs for the deposits/withdrawals are reduced.

The ATM could also be operated by a third party, who installs white-label ATMs at various locations and operates them. The benefit this third party gains from the agreement is the net profit derived from the surcharge income, after having deducted all the costs incurred (these include network membership fees, ATM purchase/rental fees, maintenance fees, etc.).

Regulatory Environment

In Canada, any individual can own or operate a white-label ATM. However, because white-label ATMs are not financial institutions, they are not covered under the *Bank Act*, and consequently are not regulated under federal jurisdiction.

Certain aspects of the industry are regulated by the following codes and standards:

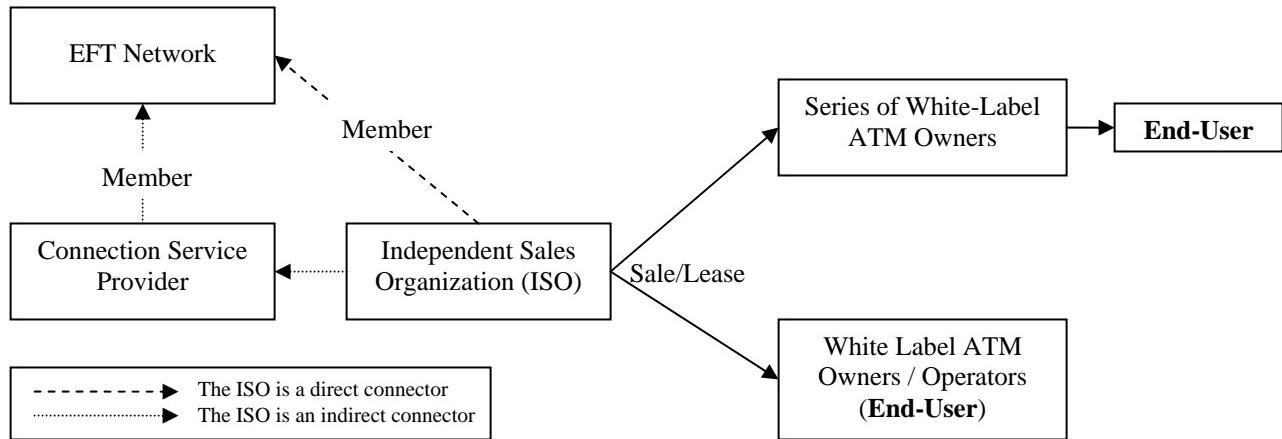
- The Office of Consumer Affairs (OCA) has a voluntary code of practice for consumer debit card services, prepared by the Electronic Funds Transfer Working Group. It outlines industry practices as well as consumer and industry responsibilities; to protect consumers in their use of debit card services in Canada.
- Rule *E1* of the Canadian Payments Association (CPA) covers the obligations of a Delivering Direct Clearer (DDC)⁴. This rule ensures that information protection and verification requirements are met during the encryption and decryption of the secret code (PIN).

These codes and standards ensure that consumers are protected during their use of debit services and that the settlement process is managed appropriately. However, the ownership of white-label ATMs itself is not currently regulated.

⁴ A DDC may act as a Settlement Agent during the white-label ATM settlement process.

Ownership Hierarchy

The following figure illustrates the relationships between the various tiers of the ownership hierarchy:



The ATM owner/operator may purchase/lease his ATM(s) either directly or indirectly⁵ from an Independent Sales Organization (ISO). Before reaching its end-user, a white-label ATM can change ownership several times, being sold to a series of white-label ATM owners.

ISOs may or may not be members of an EFT network⁶. They either transact directly through the network as direct connectors or they transact through a connection service provider/direct connector as indirect connectors⁷. Often, when the ISO operates as an indirect connector, there is no contact between the EFT network and the ISO.

It is difficult to identify the specific owners/operators of white-label ATMs at any given time. This is because of the lack of contact between the various tiers, as well as because of the number of times a white-label ATM may change ownership before reaching its end-user.

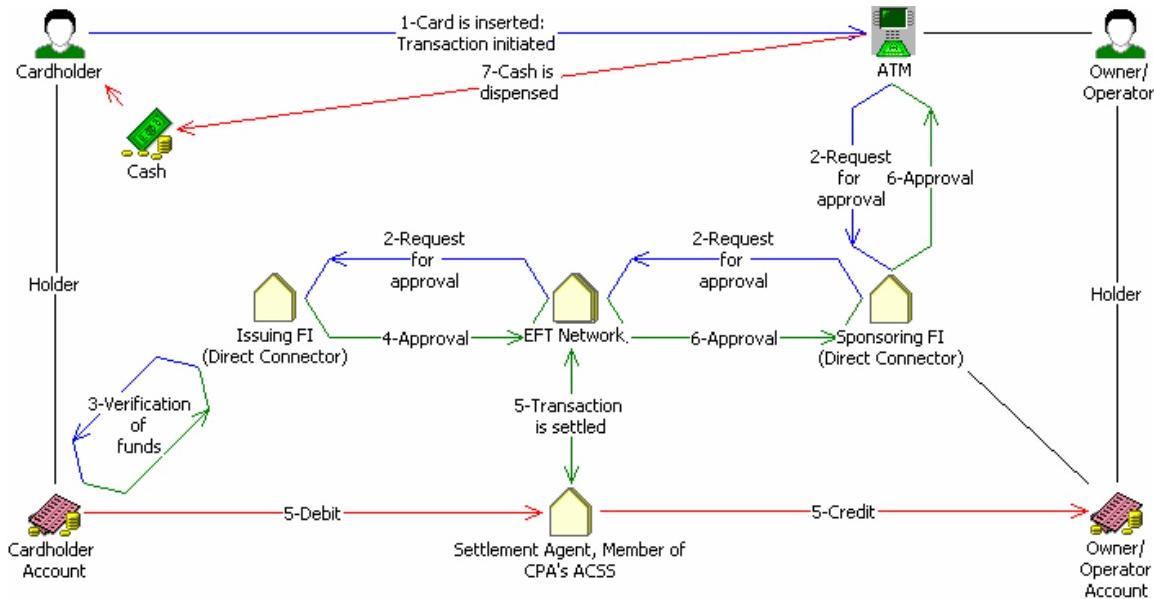
⁵ A direct sale occurs when the white-label ATM is sold directly to its end-user, whereas an indirect sale occurs when the white-label ATM is sold to a series of individuals before being sold to the end-user.

⁶ The EFT network consists of a series of interconnected members. It is responsible for routing the requests for approval as well as the confirmations that the cash can be dispensed.

⁷ Direct connectors are members of the EFT network, while indirect connectors are not. They must connect to it either through a direct connector or through a connection service provider. The connection service provider is a member of the EFT network and provides a connection service to third parties.

Settlement Process

The following chart illustrates the settlement process of a white-label ATM:



The steps to provide cardholders with the funds they have requested during a cash withdrawal at a white-label ATM are as follows:

1. The cardholder initiates the transaction by placing his card in the white-label ATM and making a request for a withdrawal.
2. The transaction clearing data is sent to the sponsoring financial institution⁸. The request for approval is then forwarded, through the EFT network⁹, to the issuing financial institution¹⁰.
3. The issuing financial institution verifies that the funds requested are available in the cardholder's account.
4. Once the funds in the cardholder's account have been verified, the transaction is validated and approved. This approval is sent back to the EFT network.
5. The transaction is settled by a settlement agent¹¹, through the Canadian Payments Association's (CPA) Automated Clearing Settlement System

⁸ The white-label ATM operator's bank account is held at the sponsoring financial institution. It allows the ATM withdrawal to be credited to a bank account.

⁹ Any incorporated entity operating in Canada is eligible for membership to Interac, Canada's debit EFT network.

¹⁰ The issuing financial institution is a deposit-taking institution that also maintains the accounts of its clients.

¹¹ Settlement agents are members of both the EFT network and the Canadian Payments Association.

(ACSS)¹². At this point, the funds are credited to the owner/operator's account

6. The approval to dispense the cash is forwarded through the direct connector (or connection service provider) to the white-label ATM.
7. The cash is dispensed to the cardholder.

II – Potential Exploitation of White-Label ATMs

The lack of regulation in the white-label ATM industry, the potential anonymity of operators due to the complexity of the ownership hierarchy, as well as certain aspects of the settlement process, could make white-label ATMs vulnerable to money laundering. This section describes the vulnerability to money laundering of white-label ATMs due to the anonymity of operators and the potential for placement activities. para. 16(1)c -ATIA

Operator Anonymity

One feature that makes white-label ATMs particularly vulnerable to money laundering is the fact that operators can remain virtually anonymous while conducting their activities. This is mainly due to the number of tiers in the ATM ownership hierarchy. As white-label ATMs are sold and re-sold to different parties, the change in ownership is not always reported to the upper tiers of the hierarchy.

Operator anonymity may facilitate the ease with which individuals linked to criminal activities can obtain and operate a white-label ATM. para. 16(1)c -ATIA

In addition, bank accounts associated to white-label ATMs are sometimes difficult to identify. A sponsoring financial institution can determine that a white-label ATM is being operated through one of their clients' accounts using the following two sources:

1. Knowledge of the client's line of business based on his initial statement and on updates to any changes to his line of business;

¹² Settlement agents enter transactions directly into the ACSS system and settle them through their settlement accounts at the Bank of Canada. In order to be eligible to become a direct clearer, an institution must: be a member of the CPA; be a deposit-taking institution or securities dealer; process payment items the volume of which is at least 0.5% of the total national volume of payment items; establish and maintain a settlement account at the Bank of Canada; and satisfy the operational requirements of the ACSS.

2. Previous activity in the account, including records of electronic credits from settlement companies and requests for large withdrawals, payable in cash.

These steps alone, however, do not allow sponsoring financial institutions to flag accounts which have not previously been identified by the client as supporting white-label ATMs. This is because white-label ATMs are not directly connected to the sponsoring financial institution. Therefore, they have not been in the radar zone for bank compliance and anti-money laundering procedures.

para. 16(1)c -ATIA

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Potential for Placement

White-label ATM operators have the option to load their ATM themselves, with cash from any source, increasing the potential for placement activities. Placement, the initial step of the money laundering process, involves placing the proceeds of crime into the financial system. This can be done in a number of ways, including the use of white-label ATMs.

If used for placement activities, a white-label ATM would be operated in the following way:

1. The white-label ATM is loaded with proceeds of crime (illegitimate funds may be commingled with legitimate funds).
2. The operator arranges to have the funds withdrawn from his machine, or lets the funds from his machine be gradually depleted.
3. A credit from a settlement company for the same amount is transferred to the operator's bank account through third party withdrawals.

Once the credit has been transferred to the operator's account, the funds have successfully been placed into the financial system. An examination of the operator's bank statement would show funds being electronically deposited into his account from a legitimate settlement agent. At this point, the proceeds of crime seem like legitimate funds.

In addition, it may be difficult for financial institutions to identify the source of funds used to fill a white-label ATM.¹³ A lack of cash withdrawals from a white-label ATM account could mean that the cash used to replenish the ATM is being obtained from an illegitimate source. However, because of the number of ATM replenishment options available to white-label ATM operators, the cash may also be obtained from a legitimate source other than the account itself (such as funds from an operator's business or from the services of a cash delivery company).

The following para. 16(1)c -ATIA



Case Example

This case demonstrates some of the ways in which white-label ATMs may be exploited for the placement stage of the money laundering process.

According to voluntary information FINTRAC received from law enforcement, individual 1, president of a white-label ATM business, was under investigation for suspected links to organized crime.

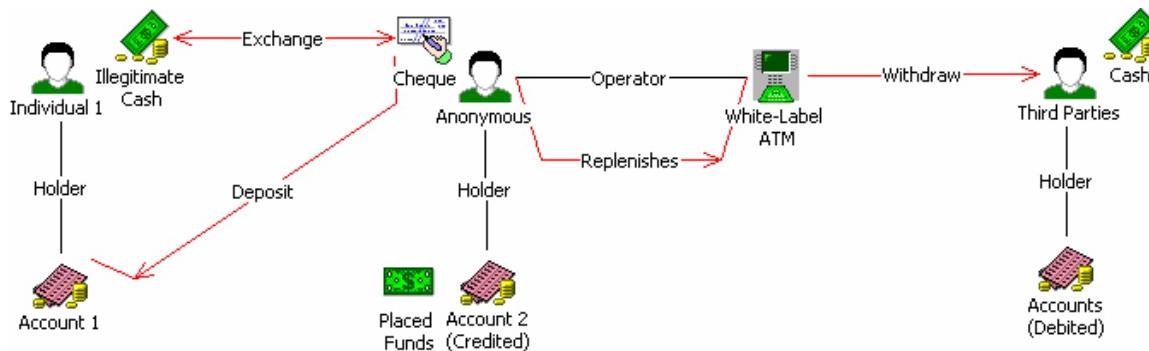
Open-source information revealed that this white-label ATM business replenished several ATMs. Some of the white-label ATMs were owned by the business, while others were contracted out to various business owners.

Financial institutions where some of the accounts of the white-label ATM business were held submitted Suspicious Transaction Reports indicating concerns that no cash was being withdrawn from the accounts in order to fill their white-label ATMs. Therefore, by replenishing their white-label ATMs with illegitimate cash, this business could have successfully placed funds into the financial system.

As well, Individual 1 stated to one financial institution, where an account was held, that the white-label ATM was replenished with cash purchased from a cash-intensive business. FINTRAC suspects that this business was also linked to organized crime.

The following chart illustrates how illegitimate cash could be placed into the financial system through a white-label ATM operator:

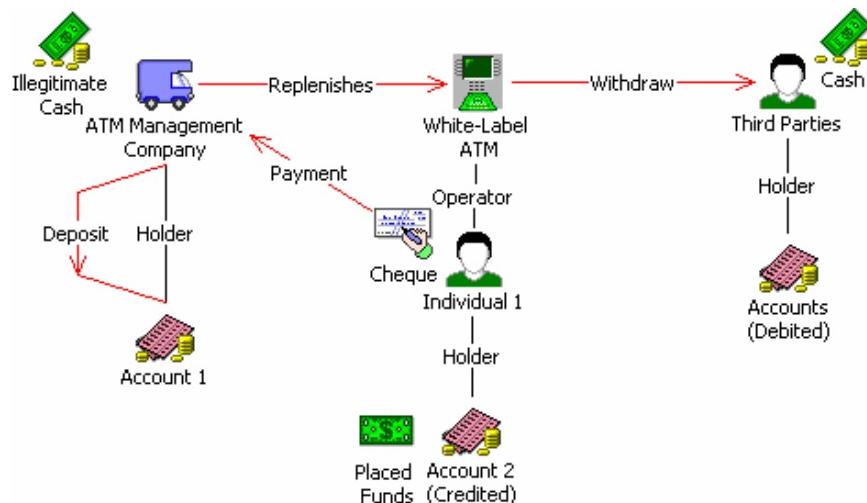
¹³ See Annex 1 for additional information on distinguishing normal from unusual account activity.



- Individual 1 sells illegitimate cash to Individual 2, a white-label ATM operator. The payment (cheque or other financial instrument) is deposited into Individual 1's account.
- Individual 2's account is debited for the amount of the payment. This concurs with the normal activity of a white-label ATM account (large withdrawal from account to refill the white-label ATM).
- Individual 2 replenishes the white-label ATM with the illegitimate cash that was purchased.
- The funds from the white-label ATM are gradually depleted as third parties make cash withdrawals at the ATM. The withdrawals are credited to Individual 2's account.
- The illegitimate funds have successfully been placed into the financial system. Interestingly, the individual from which the illegitimate cash was purchased seems several steps removed from the actual placement of the cash into the financial system.

para. 16(1)c -ATIA

The following chart illustrates how an ATM cash management company could use illegitimate cash to replenish the white-label ATMs it serviced:



- Individual 1 makes a payment to the ATM cash management company, in the form of a cheque, electronic transfer, etc.
- The payment is received by the ATM cash management company and is deposited into an account.
- The ATM cash management company replenishes Individual 1's white-label ATM with illegitimate cash.
- Individual 1 may not be aware of the illegitimate source of the funds used to replenish the white-label ATM, since this portion of the ATM management activities has been outsourced.
- The funds from the white-label ATM are gradually depleted as third parties make cash withdrawals at the ATM. The withdrawals are credited to Individual 1's bank account.
- The illegitimate funds have successfully been placed into the financial system. Once again, the ATM cash management company is removed from the actual placement of the cash into the financial system.

Concluding Remarks

This paper has described the advantages of owning/operating a white-label ATM, the loose regulatory environment in which white-label ATMs operate, the complexity of the ownership hierarchy, as well as the settlement process of white-label ATMs. It has also detailed two reasons for which white-label ATMs could be exploited for money laundering purposes: operator anonymity and the potential for placement due to self-loading of the cash.

In order to decrease the vulnerability to money laundering of white-label ATMs in Canada, several options must be considered. The mandatory registration of ATM owners would reduce their anonymity, as it would allow for closer monitoring on behalf of gate-keepers (bankers and accountants). Education and accountability of these gate-keepers, by ensuring thorough monitoring, must also be an option. Finally, the inability for personal owners to load funds themselves into their white-label ATMs would reduce the possibility for money launderers to place funds into the financial system using this method.

Other countries are becoming more and more aware of the importance of establishing anti-money laundering obligations in order to diminish the vulnerability of white-label ATMs. In their most recent mutual evaluation by the Financial Action Task Force, the United States identified white-label ATMs as a potential money laundering risk. The importance of introducing a registration and monitoring system for white-label ATM owners was emphasized, stating that there was no oversight for their use in the majority of states. As well, Hong Kong's Financial Intelligence Unit requires that ATM operators submit reports describing suspicious transactions that have occurred at their ATMs. Until specific regulations are established for Canada, white-label ATMs will continue to be vulnerable to money laundering.

Annex 1 – Account Activity

1a) Normal Account Activity

The following six steps outline the process a white-label ATM operator follows to replenish his machine with cash:

1. Cash is obtained to refill the white-label ATM, typically through a bank withdrawal or through an electronic transfer to a cash management company.
2. The operator arranges to have the cash delivered to his white-label ATM.
3. The white-label ATM is replenished using the cash.
4. The cash in the machine is gradually depleted, through third party withdrawals.
5. Credits from a settlement company for the same amount as the withdrawals are deposited into the operator's bank account.
6. When the white-label ATM is close to being empty, the cycle repeats itself.

Typically, an account used for the operation of a white-label ATM should contain the following transactions:

- Credits from one or several white-label ATM settlement agents (these include Datawest, Open Solutions, TNS Smart Network, Online Service Corp, Calypso Canada, etc.);
- Debits of approximately the same amount as the credits in order to fill the white-label ATM (cheques payable to cash, cash withdrawals, electronic transfers to a cash management company, etc.).

1b) Unusual Account Activity

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Change in account activity

Once a particular concern is raised with the client and the explanation provided, the account activity should not drastically change. For example, if the financial institution staff comments on the unusually high amount of credits from settlement companies, the dollar amount of the credits should not drastically decrease for no apparent reason.

Additional money laundering indicators, cited in a paper by the New York State Police¹⁵, include:

- The average withdrawal amount surpasses the \$60 national average. This could indicate attempts to withdraw as much money as possible in a minimal amount of transactions.
- The bulk of the transactions occur at a time which is inconsistent with a large volume of business. For example, transactions that occur near midnight allow an individual to withdraw the maximum amount for two days at the same time.
- Above average surcharges. In this situation, the surcharge could be the payoff to the merchant for his assistance in laundering the funds.

¹⁵ SULLIVAN, Kevin, *A Review and Analysis of the Privately Owned ATM Industry*, New York State Police, March 2004, p.11.